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1 UNITED STATES DISTRICT COURT
2 SOUTHERN DISTRICT OF NEW YORK

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3 SECURITIES AND EXCHANGE
4 COMMISSION,

Plaintiff,

v.

15 CV 894 (WHP)

6 CALEDONIAN BANK LTD., et al.,

7 Defendants.

8 -----x

9 New York, N.Y.
10 July 16, 2015
3:00 p.m.

11 Before:

12 HON. WILLIAM H. PAULEY III,

13 District Judge

14 APPEARANCES

15 SECURITIES AND EXCHANGE COMMISSION

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23 Caledonian Securities Ltd.

24 BY: MARGARET A. DALE

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(Case called)

MR. WILLIAMS: Good afternoon. David Williams for the SEC with my colleagues Richard Simpson, Ernesto Amparo, and Jack Kaufman from our New York regional office.

THE COURT: Good afternoon to you.

MR. ZITO: Good afternoon. Carter, Ledyard & Milburn for the defendant Vermont by Bob Zito. I'm joined by Mark Zancolli, Brandon Isaacson, and Theodore McDonough.

THE COURT: Good afternoon, Mr. Zito.

MS. DALE: Margaret Dale for Caledonian Bank and Caledonian Securities.

THE COURT: Good afternoon. This is oral argument on Vermont's motion. Do you wish to be heard, Mr. Zito?

MR. ZITO: Your Honor, we believe that this is a very simple motion, quite frankly.

THE COURT: If you would be kind enough to take the podium.

MR. ZITO: I'm sorry, your Honor.

THE COURT: Thank you.

MR. ZITO: We view this motion as being a very simple one. We are resting in most part our reliance on Section 4(a)(3), which is the dealers exemption under Section 4 of the Securities Act. That exemption exempts transactions which have occurred at any point after 40 days after the registration statement has been deemed effective, so the registration was

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1 effective. There are undisputed facts in this case, your
2 Honor. There are only two sets of undisputed facts. Those are
3 when the registration statements were deemed effective by the
4 SEC. Your Honor may take judicial notice of that. That is a
5 matter of EDGAR, it is right on the EDGAR website, on the SEC's
6 own website, so we have that date, and then we have the date
7 when the first transactions occurred.

8 Your Honor, I have provided to the Court some
9 demonstrative exhibits that show that when those transactions
10 did occur and the pedigree, if you would, of how they were
11 acquired. And in our reply memorandum, your Honor, we have
12 provided a chart for the Court. It appears on page four of the
13 reply memorandum. There is a little chart there that shows
14 when the securities were actually sold. And references to how
15 that is demonstrated in the record.

16 I don't think that these are facts which are in
17 dispute, your Honor. And as you can see from the dates of when
18 the transactions occurred, they are significantly after the
19 40-day period.

20 THE COURT: Doesn't the 40-day period, isn't it also
21 measured from the date of offering to the public?

22 MR. ZITO: It is. There is case law that says that
23 that date, when it is offered to public, is when the
24 registration statement is effective. Is stated effective.
25 That is the date. So the minute that the SEC says that the

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1 registration statement is effective, that is when it is offered
2 to the public. And we have case law on that to which we cite
3 in both our memo and our reply.

4 THE COURT: Why doesn't *Cavanagh* control here?

5 MR. ZITO: Your Honor, *Cavanagh* was an S-8 case. An
6 S-8 is a specific offering for employees stock offerings. It
7 is a stock offering for corporate officers, directors and
8 employees, which, by its own terms under that provision, limits
9 the offering only to those people and cannot then be reissued.
10 It is not an S-1 case. Once an S-1 registration statement has
11 been filed and once the 40-day period has elapsed, a dealer is
12 pretty much able to sell those without any liability.

13 THE COURT: But, in *Cavanagh*, didn't the Second
14 Circuit say that the SEC could bring a claim even if a
15 registration statement was filed?

16 MR. ZITO: I think that case is limited to the facts
17 of that case, your Honor. An S-8 offering is limited by its
18 very nature, and in order for the transaction to have occurred
19 as to what they were trying to have occurred, under the facts
20 of *Cavanagh*, they were trying to get it out of the hands of the
21 directors and officers who received the S-8 stock, and they
22 tried to through a very certificates merger. And the SEC and
23 Second Circuit said you couldn't do that without an additional
24 registration statement.

25 THE COURT: How do you respond to the SEC's argument

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1 that Vermont sold outside the terms of the registration
2 statement?

3 MR. ZITO: To the extent that the SEC argues, as I
4 understand their argument, that the registration statement was
5 confined to the four corners of the people to whom it was being
6 sold to, that's why we have exemptions. If we look at Section
7 4 of the Exchange Act, of the Securities Act, rather,
8 specifically, liability for unregistered securities only
9 applies to issuers, underwriters, and dealers, and then only to
10 dealers after the 40-day period. There is a specific exemption
11 for brokers who have conducted due diligence.

12 So, even assuming arguendo that the SEC is correct in
13 their proposition, and intuitively it can't really be correct
14 because you couldn't have securities markets unless you were
15 filing registration statements all the time. The reason why
16 you're not filing registration statements all the time is
17 because they're exempt transactions. And that's why the SEC is
18 wrong, quite frankly, your Honor.

19 THE COURT: Does the SEC need to prove the issuers
20 controlled the initial foreign shareholders individually?

21 MR. ZITO: Absolutely, your Honor. We have -- if
22 we --

23 THE COURT: Would it be enough for the SEC to show
24 that no distribution was made to shareholders generally?

25 MR. ZITO: Not in order to rebut the exemption, your

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1 Honor. We have proven through undisputed and undisputable
2 facts that the dealer exemption applies here and that we are
3 protected by that.

4 If the SEC wants to take the position, which I believe
5 they are, that, well, that exemption does not apply, because in
6 fact Vermont's customers were in effect statutory underwriters
7 under Section 2(a)(11). Then they must prove, in order to
8 rebut the presumption about the exemption, they must prove that
9 the people or customers from whom we acquired the stock from,
10 that's Vermont's customers, were either issuers -- and they
11 weren't -- or controlled by the issuers. And control by the
12 issuers means that they had some sort of governmental control.
13 They owned 90 percent of the stock in the company. That they
14 were related. Their decision making was effected.

15 THE COURT: Doesn't the timing and volume of the
16 transactions suggest that Vermont's clients acted as issuers?

17 MR. ZITO: Your Honor, that is mixing apples and
18 oranges. What the SEC tries to emphasize is the volume of
19 stock. What they forget to mention is that, number one, none
20 of Vermont's clients ever owned more than 5 percent of the
21 issue at the time. It never owned more than 5 percent. And
22 they acquired the stock over time. They bought and sold. All
23 right. But, what they emphasize is the word "distribution."
24 What they're doing is they're picking and choosing from the
25 definition of what underwriter is.

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1 Section 2(a)(11) defines what a statutory underwriter
2 is. And "distribution" is part of that definition, but the
3 first part, which they don't address at all in their papers,
4 your Honor, is the fact that, in the first instance, an
5 underwriter must have acquired the stock from an issuer or from
6 someone controlled by an issuer. They don't answer that
7 question at all. All they say is, well, this must have been a
8 distribution. Well, that doesn't answer the question, your
9 Honor.

10 THE COURT: Don't they make that allegation in their
11 complaint?

12 MR. ZITO: They make the allegation that they are an
13 underwriter without ever alleging how they are underwriters or
14 how there is some control element over the sellers of the stock
15 to Vermont's customers. That's never alleged, your Honor.
16 And they have no proof of that.

17 THE COURT: On this motion, there is a big difference
18 between proof and allegations, aren't there?

19 MR. ZITO: Not necessarily, your Honor. We've
20 referred to -- this is a judgment on the pleadings motion as
21 opposed to a motion to dismiss. And we have cited case law in
22 our papers that say that the Court may look at defenses and the
23 Court may look at both sides of the case and to search the
24 record to see whether there is really a case here. Not just as
25 to the way the case has been alleged.

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1 THE COURT: All right. I want to change focus for a
2 moment, because you helpfully submitted yesterday the
3 demonstratives that you proposed to use during your argument,
4 and I have a good grasp on two of them. But I really don't
5 fully understand what is going on with the presplit Norstra
6 shares. Could you take me through it a little.

7 MR. ZITO: May I have the liberty of the courtroom,
8 your Honor?

9 THE COURT: Sure.

10 MR. ZITO: Your Honor, in order to --

11 THE COURT: I assume that you've provided these
12 demonstratives to the SEC.

13 MR. ZITO: Of course, your Honor.

14 The Goff offering as well as the Xumanii offerings
15 were made pursuant to a sale of selling shareholders. That is
16 to say Norris and Crowley were existing shareholders under the
17 Goff offering. That's how Lornex acquired their stock.

18 THE COURT: I got that one.

19 MR. ZITO: The same is true with respect to the
20 Xumanii transaction.

21 THE COURT: Right.

22 MR. ZITO: The Norstra was a best efforts offering.
23 In other words, it was the company that was selling stock.
24 Garpenfeldt, Sanchez, and Palmer acquired their stock not from
25 existing shareholders, but directly from the company. Lornex

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1 then acquired the stock from those entities.

2 And by the way, we submitted an opinion letter from
3 counsel saying that the stock was free and clear and able to be
4 traded. That's part of the record and I can give you a record
5 reference on that, your Honor.

6 Then, the stock went through a series of transactions.
7 The purpose of this exhibit is to demonstrate how Vermont's
8 customers acquired their stock. That is to say Bartlett,
9 Lornex, Nautilus, Nautilus and Nautilus. This is the pedigree
10 from whom they got their stock.

11 The purpose of this chart, your Honor, is to
12 demonstrate that it is the SEC's burden to demonstrate that
13 Tamarind, Pegasus, Isla, Mariposa, Coldstream, were either
14 issuers or controlled by the issuer. The issuer being Norstra
15 itself. They don't allege that. In fact, the complaint
16 doesn't even mention any of these entities' names nor does it
17 allege or explain in what manner they are supposedly controlled
18 by Norstra. That's the only way that they can demonstrate that
19 there was some sort of a distribution. A distribution ceases
20 once the stock gets to the public. And distribution is only
21 one part of the definition of what a statutory underwriter is.
22 The first part of the definition is you must first acquire it
23 from an issuer. There is a ton of case law out there that says
24 an underwriter gets the stock, acquires the stock from the
25 issuer or someone controlled by the issuer, and sells to the

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1 public.

2 Have I explained that, your Honor?

3 THE COURT: Yes. But the number of shares, when we
4 get to the transactions with Tamarind, Pegasus, what is the
5 relationship between Tamarind and Pegasus Global?

6 MR. ZITO: There is no known relationship, your Honor.
7 There is no known relationship between any of these entities.

8 THE COURT: Where are the shares coming from?

9 MR. ZITO: We have documents that can show this train.
10 We were only required, because these are our clients, to see
11 where they were getting their stock from. And this is where
12 they got their stock from. We don't know, nor does the SEC
13 know to my knowledge, know how Pegasus, these other investment
14 companies, acquired their stock. Nor do I believe we're
15 required to prove that, your Honor.

16 Again, the dealers exemption focuses on this date,
17 which is 7/12/12, and then 40 days thereafter, which is when
18 Lornex actually effects the first sale, which is almost a year
19 later. Well in excess of the 40-day period. Therefore, the
20 exemption applies, based on undisputed and undisputable facts.
21 And if the SEC believes that these entities were issuers or
22 controlled by the issuers, which would trigger potential
23 underwriter liability upon Verdmont's customers, then they have
24 to prove that. They have to at least allege it. They don't
25 even allege it. They just say this was a distribution in very,

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1 very broad strokes. This was a sham. They use conclusory
2 language. There are no evidentiary facts that they use at all.
3 There is not a shred of evidence that they deliver.

4 So even assuming that they allege a case, your Honor,
5 I don't know how they could ever prove this case.

6 THE COURT: You can return to the podium.

7 MR. ZITO: Thank you.

8 THE COURT: Thank you. What about the SEC's argument
9 that Vermont was required to do a more searching inquiry into
10 the transactions?

11 MR. ZITO: I believe your Honor is referring to the
12 broker's exemption. There are two standalone independent
13 exemptions. One is the dealer's exemption and one is the
14 broker's exemption. If the dealer's exemption applies, then
15 the broker exemption is irrelevant. It is moot. Because the
16 transactions were exempt. If your Honor finds that the dealer
17 exemption does not apply for whatever reason, then we would go
18 to the broker exemption, and we would then demonstrate that we
19 conducted due diligence, we found out who the principals of all
20 our clients were, we noticed that the principals of our clients
21 had no relationship with either the issuer or any of the other
22 entities. And there is no way, this is assuming that our
23 clients were acting as underwriters. In order for them to be
24 acting as underwriters, they must have acquired the stock from
25 the issuer or an entity controlled by the issuer. And the SEC

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1 does not explain what we should have done more or how we could
2 have discovered that, and indeed they don't even allege that in
3 the complaint, they don't even allege the controlling nature of
4 this. So, if they don't apparently know what the nature of the
5 controlling relationship is, they apparently don't know how we
6 could have found that out.

7 THE COURT: Anything further?

8 MR. ZITO: Nothing further, your Honor.

9 THE COURT: Thank you.

10 MR. WILLIAMS: Good afternoon, your Honor. Mr. Zito
11 is apparently resting at this point on the dealer's exemption
12 under Section 4(a)(3) of the Securities Act. And he points to
13 the date of the registration statements, the S-1 registration
14 statements with respect to each of the three issuers, and
15 argues that 40 days had run since the point of the registration
16 statement, so these sales were exempt.

17 As your Honor noted, it is not simply the date of the
18 effective date of the registration statement that triggers --
19 that undermines the exemption. It is also the date that the
20 securities, the first bona fide offered to the public.

21 THE COURT: Let's just back up though for a moment.

22 MR. WILLIAMS: Sure.

23 THE COURT: How can the SEC make a prima facie case
24 here when the registration statement were filed?

25 MR. WILLIAMS: Your Honor, I don't think that Mr. Zito

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1 was arguing we haven't made a prima facie case. I think the
2 registration statement describes sales of securities, other
3 than the sales of securities that are at issue in this case.
4 Other than Verdmont's sales. Other than the sales of Lornex,
5 Norstra and Bartlett Trading. Those securities are not covered
6 by these registration statements.

7 In *Cavanagh*, the Second Circuit made clear that each
8 transaction, that each sale of a security must either be
9 pursuant to a registration statement, subject to an exemption,
10 or it's illegal. Those are the only three possibilities for
11 each sale of a security. The sales of securities described in
12 those S-1 registration statements are not the sales and
13 security at issue here.

14 THE COURT: But *Cavanagh* was an S-8 registration
15 statement, wasn't it?

16 MR. WILLIAMS: Yes. An S-8 registration statement is
17 limited to certain types of securities sales, and S-1 is more
18 of a general offering. But, both registration statements
19 describe sales of securities. That's the purpose of --

20 THE COURT: But S-8s describe sales essentially to
21 insiders, don't they?

22 MR. WILLIAMS: Yes. And S-1s can frequently describe
23 sales of securities to the general public. In this particular
24 case, the S-1s, at least one of the S-1s describes sales to
25 certain individuals as opposed to a public offering.

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1 What we allege is that these offerings, pursuant to
2 the registration statements, were not actual offerings. What
3 we allege in the complaint is that the securities were sent to
4 a transfer agent, the transfer agent was told that pursuant to
5 this registration statement the securities were exempt. The
6 transfer agent removes the restrictive from the securities and
7 sends the securities back to the issuer. These securities
8 didn't go to investors. They went, as far as the evidentiary
9 trail indicates, these securities went back to the company.

10 THE COURT: Weren't the foreign shareholders named in
11 the S-1s?

12 MR. WILLIAMS: Yes.

13 THE COURT: Didn't the S-1s say that they had no
14 affiliation with the issuer?

15 MR. WILLIAMS: That's what they said.

16 THE COURT: What else should they have said?

17 MR. WILLIAMS: Well --

18 THE COURT: Does the SEC have any information or good
19 faith basis to plead that they were insiders or affiliates,
20 that they were affiliated with the issuer?

21 MR. WILLIAMS: This is what we know about the
22 securities that went to the individuals, your Honor. The
23 securities were sent back to the issuer. And that these
24 securities were doled out to various IBC entities at the
25 direction, at the direction of someone who is clearly working

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1 with the issuer.

2 THE COURT: I have a problem with that. The amended
3 complaint simply alleges that Empire, the transfer agent, sent
4 the stock certificates to Goff's counsel. Right?

5 MR. WILLIAMS: Right.

6 THE COURT: Who then sent them, according to the
7 complaint, to O'Flynn, right?

8 MR. WILLIAMS: Right.

9 THE COURT: How does that show that the Irish
10 shareholders never received them?

11 MR. WILLIAMS: Well, the indication is that the
12 transfer agent, as I said, sent them back to the company.

13 THE COURT: Isn't that pure speculation?

14 MR. WILLIAMS: So, there is no evidence that the
15 shares were disseminated to the investors. But let's say that
16 actually happened.

17 THE COURT: The S-1 says it was. Right?

18 MR. WILLIAMS: Okay. So let's say they were
19 disseminated to the investors. What happens after that, is
20 that the shares are transferred from the name of the investors
21 to Lornex, for instance. In Mr. Zito's first chart there, the
22 shares are transferred from Norris and Crowley to Lornex.

23 Now, there is a securities purchase agreement that was
24 produced that indicates that the signatures of both Norris and
25 Crowley were guaranteed by O'Flynn. O'Flynn is the CEO of

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1 Goff. And that securities purchase agreement was
2 transferred -- was sent to the transfer agent in order to
3 effect the transfer of the shares from Norris and Crowley to
4 Lornex.

5 Now, what the transfer agent says is that on the
6 signature of O'Flynn alone it would not have transferred the
7 shares. What we also have is a board resolution directing the
8 shares of Norris and Crowley to be transferred to Lornex.

9 Now, there cannot be, I would suggest, clearer
10 evidence of corporate control over the transfer of shares than
11 a board resolution directing that the shares be transferred and
12 guaranteeing that the signatures were in order. The fact that
13 Mr. Norris and Mr. Crowley's shares were transferred in a
14 coordinated fashion at the direction of a company itself is
15 substantial evidence that the company controlled this transfer
16 of shares, irrespective of whether or not they ever landed in
17 the hands of Norris or Crowley or not.

18 THE COURT: Isn't it just a matter of what standards
19 Empire wanted to require to perform the transfer of shares?

20 MR. WILLIAMS: Well, if the company is exercising
21 power to direct the transfer of shares, that is evidence of
22 control over the shares. On that point I would direct your
23 Honor to a decision of the Ninth Circuit in a case called *SEC*
24 *v. Platforms Wireless*. In that case, the Ninth Circuit was
25 reviewing a grant of summary judgment in favor of the

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1 commission on the issue of underwriter status for the
2 defendant. And the Ninth Circuit rejected the argument that
3 the transfer of ownership of the securities from a corporate
4 affiliate to his wife raised a genuine issue of fact as to
5 control. And the court said ownership is one means of control,
6 but it is not the only means, and multiple persons can control
7 simultaneously. The defendant's position is a top-ranking
8 officer of the company with the explicit power to direct the
9 specific share transfers at issue establishes control resting
10 on his title and role at the company, and that conclusion is
11 not contradicted by the mere fact of an ownership transfer.
12 That's at 617 F.3d 1072.

13 THE COURT: Courts can confront spousal transfers all
14 the time.

15 MR. WILLIAMS: True.

16 THE COURT: That doesn't seem to add much, if it is
17 obvious.

18 MR. WILLIAMS: Sure.

19 THE COURT: How does that relate to the situation
20 here?

21 MR. WILLIAMS: Well, your Honor, you have a number of
22 different shares being transferred in a coordinated fashion at
23 the direction of the company. If the company is exercising
24 control over the shares of the company itself, it is
25 obviously -- I'm not sure how the company could not be in

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1 control of the transaction if it is directing the transfer.

2 With respect to Mr. Zito's argument that the date of
3 the registration statement controls, he did cite to some Second
4 Circuit authority on that point suggesting that the
5 registration date -- the date of the registration statement
6 might be the date of public offering.

7 But in a subsequent case, the Second Circuit clarified
8 that dicta in a case called *P. Stolz Family Partnership v. Daum*
9 at 355 F.3d 92. The Second Circuit held that the registration
10 is merely the manifestation of the underlying test which is the
11 genuineness of the offering to the public. And that the
12 relevant question was when the stock was really and truly
13 genuinely being offered to the public, as opposed to say a
14 simulated offering.

15 That's what we believe we have here: A simulated
16 offering. A case in which transfers are made to various
17 foreign individuals and entities on paper, where the form of
18 the transaction is a transfer of shares, but in substance, the
19 shares are in fact given back to the company.

20 On paper, the shares are transferred from these two
21 individuals to Lornex, for instance. But in substance, the
22 company is directing the transfer of its own shares.

23 If the company, even assuming that the individuals who
24 receive these shares did receive the shares in registered
25 offerings, if the company is later distributing these same

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1 shares, you can't rely on one offering to cover subsequent
2 distributions of shares. And to the extent that a
3 distributions reflected in the S-1s are complete when the S-1
4 says they're complete, these are inarguably different
5 distributions than securities.

6 THE COURT: But it wasn't the company that was
7 distributing the shares later was it? It was the chain of
8 shareholders.

9 MR. WILLIAMS: But, when you say the chain of
10 shareholders, the chain of -- these shares are being
11 transferred by the shareholders in unison. In a coordinated
12 fashion at the direction of the company. So when the company
13 is directing these transfers in a coordinated fashion, the
14 company is controlling those transfers. And as such, the
15 parties who are being directed by the company are under common
16 control with the issuer and are treated as issuers.

17 THE COURT: Hypothetically, let's assume that the
18 initial Irish shareholders of Goff were affiliates of the
19 issuer. Okay.

20 MR. WILLIAMS: Yes.

21 THE COURT: And they filed the S-1. If I bought
22 shares without knowing that, would I have to file another
23 registration statement to resell my shares?

24 MR. WILLIAMS: Could you repeat the hypothetical, your
25 Honor?

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1 THE COURT: Let's assume that the Irish shareholders
2 in Goff were affiliates of the issuer.

3 MR. WILLIAMS: Yes.

4 THE COURT: And the S-1 was filed here, as it was. If
5 I bought shares from them, would I be subject to having to file
6 another registration statement to resell my shares?

7 MR. WILLIAMS: So if you as an individual investor
8 bought Mr. Norris' shares and wanted to resell them.

9 THE COURT: Right. And I didn't know that they were
10 affiliated individuals with the issuer. Would I nevertheless
11 have to file a registration statement to sell my shares?

12 MR. WILLIAMS: Your Honor, if you buy from an
13 affiliate or an issuer with the intent to sell the securities,
14 then you are acting as an underwriter.

15 THE COURT: So the answer to my question is "yes."

16 MR. WILLIAMS: Yes. If you are buying shares from
17 Mr. Norris or Mr. Crowley and they are affiliates of the
18 issuer, and you buy these shares with the intent to resell them
19 to the public, as opposed to for investment purposes, you are
20 acting as an underwriter. And the unique aspect of this case
21 is that these are companies that at the time of these
22 transfers, they did no business. They had no revenues. There
23 is no investment intent in someone buying these shares because
24 there is nothing to invest in. The only purpose is to acquire
25 these shares, to try and turn them around as a part of what we

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1 believe is a scheme to promote the stock.

2 There is no business here. There is no investment
3 intent that one might buy shares from Mr. Norris or Crowley
4 from. It is merely a circuitous route to distribute these
5 issuer shares to the public upon commencement of the
6 promotional activities.

7 THE COURT: What about if we assume that they were not
8 affiliates? That they were not affiliated with the issuer?
9 Would an ordinary member of the public, like me, have to file a
10 registration statement?

11 MR. WILLIAMS: If you --

12 THE COURT: If I had bought the shares and was trying
13 to sell them. Resell them.

14 MR. WILLIAMS: If an ordinary member of the public
15 bought the shares from Mr. Norris' 210,000 shares and wanted to
16 resell them to the public, and Mr. Norris had no connection
17 with the company, again, the question is are you buying from an
18 issuer with the intent -- with the intent to distribute them?
19 If you're not buying --

20 THE COURT: I'm buying from Norris, and for the
21 purposes of this hypothetical, we are assuming that Norris is
22 not affiliated with the issuer.

23 MR. WILLIAMS: I think that generally speaking the
24 answer to the question is no, your Honor, because the shares
25 have been distributed to the public. That said, the Second

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1 Circuit has been pretty clear that an issuer's distribution
2 extends through the entire process by which the shares leave
3 the issuer and come to rest in the hands of the investing
4 public. So if you're talking about a large block of securities
5 that have not been previously distributed to the public that
6 emanate from an issuer, there is at least a question of fact as
7 to whether or not this is a distribution. And acting as an
8 intermediate step within the context of a distribution will
9 confer upon you underwriter status. Whether you know it or
10 not. If you are acting as an intermediary to help this issuer
11 disseminate its shares to the investing public, you are an
12 underwriter.

13 So, the question would be in your hypothetical whether
14 or not this is part of a distribution. And that's a factual
15 question.

16 THE COURT: I'm having difficulty understanding the
17 SEC's argument that, on the one hand, the registration
18 statement was a sham, and on the other, you argue that there
19 was really no registration statement here for these sales.

20 MR. WILLIAMS: Well, what we're saying, your Honor, is
21 that based on how the facts appear, it does not appear there
22 was any sort of genuine or bona fide offering of the securities
23 to the public. But, I'm not sure I follow exactly --

24 THE COURT: If the registration statement is needed
25 for every sale.

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1 MR. WILLIAMS: Yes.

2 THE COURT: Why do you need to make an argument about
3 the registration statements being a sham?

4 MR. WILLIAMS: Well, I think it explains what is going
5 on here. It explains why Mr. Norris and Crowley, whether they
6 legitimately received the share certificates or whether they
7 didn't, they are essentially part of the issuer. They are part
8 of the issuer distribution. Because as we set out in our
9 papers and we allege in the complaint, the transfers of
10 securities through them, through Lornex and ultimately sold to
11 the public in a coordinated fashion on March 18, was the path
12 by which these shares emanated from the issuer to the public.
13 And so, whether or not we believe that the registration was a
14 sham, for the reasons that we set forth, the securities were
15 sent back to the company. After the securities were sent back
16 to the company, we see an entity called Celtic Consultants.

17 THE COURT: What is that entity?

18 MR. WILLIAMS: It is an entity in Canada that
19 exercised control over a significant number of these
20 transactions.

21 THE COURT: Who controlled Celtic Consultants?

22 MR. WILLIAMS: We don't exactly know who controls
23 Celtic Consultants, your Honor. But what we do know about
24 Celtic Consultants is that Celtic Consultants, the transaction
25 that you see there with respect to the Norstra shares, that

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1 these four million shares are transferred to Lornex. They were
2 transferred at the direction of Celtic Consultants sending an
3 advice to the transfer agent directing transfers into any
4 number of entities. We see the transfer from Lornex to Jackson
5 Bennett was also directed by Celtic Consultants.

6 THE COURT: Starting on that first point about Celtic
7 Consultants and Lornex.

8 MR. WILLIAMS: Yes.

9 THE COURT: Don't you need to show a connection
10 between Celtic Consultants and the issuer for your sham theory
11 to have any factual support?

12 MR. WILLIAMS: Well, we do show a connection between
13 Celtic Consultants and the issuer, your Honor, because what we
14 show is that Celtic Consultants is directing these -- is
15 sending these directions to transfer these shares to the
16 placement agent accompanied with board resolutions from the
17 company. So clearly, Celtic Consultants is working with the
18 company, because in each of these transfer directions, Celtic
19 Consultants is providing the transfer agent a board resolution
20 directing the transfer of shares. We see the interaction --

21 THE COURT: How do you know that's just not a
22 procedural mechanism?

23 MR. WILLIAMS: A procedural -- how do I know what is
24 not a procedural mechanism, your Honor?

25 THE COURT: Celtic Consultants is involved just

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1 administratively, procedurally.

2 MR. WILLIAMS: It may be, your Honor. Even if that's
3 the case, there is common control being exercised over all of
4 the securities. And if --

5 THE COURT: How do you know? Where is that alleged in
6 the complaint, in the amended complaint?

7 MR. WILLIAMS: It is.

8 THE COURT: How do you know it?

9 MR. WILLIAMS: It is alleged that the boards of the
10 various companies entered resolutions directing the transfer of
11 the shares. And as I explain, your Honor, that's an indication
12 that the company itself is directing control over the transfer
13 of these shares.

14 And the issue of Celtic Consultants directing the
15 transfers to Lornex go the other way. The shares that go to
16 Lornex in this transaction are approximately 300,000 less than
17 the shares that were purportedly sold to it. Lornex directs
18 those shares to go to some other entity at the direction of
19 Celtic Consultants. What we see here is Celtic Consultants
20 divvying out the shares of each of the issuers into various
21 entities, these entities received the shares and begin selling
22 the shares in what appears to be a coordinated fashion at the
23 same time. Prior to the sales undertaken by these entities,
24 the public can't buy these shares.

25 Your Honor, your Honor posited a hypothetical of

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1 buying Mr. Norris' shares or Mr. Crowley's shares. Unless you
2 came upon one or the other of them, you'd never have a chance
3 to, because they weren't available to be bought prior to the
4 public offering in the securities on the date in which the
5 promotional -- the day after the promotional activities began
6 and the selling commenced.

7 THE COURT: What is the link between Celtic
8 Consultants and the issuer?

9 MR. WILLIAMS: The link between Celtics Consultants
10 and the issuer is Celtic appears to be directing the transfer
11 of the issuer -- of millions of shares of issuer securities to
12 the placement agent, and accompanying these transfer directions
13 are board resolutions from the company authorizing and
14 indemnifying the transfer agent for the transfers.

15 THE COURT: What if Celtic Consultants was taking
16 direction at the shareholder's request?

17 MR. WILLIAMS: If the Celtics Consultants were taking
18 direction at the shareholder's request, they were still acting
19 pursuant to the issuer's authority to transfer the shares,
20 because the placement agent would not have effected the
21 transfers for the reason that the stock purchase agreements did
22 not have what they call medallion guarantees for the
23 signatures. So, the only way that these shares could be
24 transferred was pursuant to a board direction indemnifying the
25 transfer agent from making the transfers.

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1 So, we have the board essentially authorizing these
2 transfers in a coordinated fashion with Celtic. Whether Celtic
3 is taking direction from the company or the company is giving
4 direction to the Celtic, there is coordinated control being
5 exercised over all of these shares by the company.

6 THE COURT: If I'm the shareholder and I'm giving
7 direction to transfer the shares, and the transfer agent may
8 insist on certain protocols, whether it is a medallion or a
9 board of directors resolution or something else, right?

10 MR. WILLIAMS: Yes. And in *SEC v. Kern* there was a
11 situation where the shareholders had given over powers of
12 attorney to the control person to allow the control person to
13 transfer the shares. And they knew that they were doing that
14 and they were willing to go along with that. But at the same
15 time, because they were acting in coordination with the issuer,
16 the Second Circuit held that that common control transformed
17 all of those individuals into the issuer.

18 THE COURT: Where is there any allegation like that
19 here?

20 MR. WILLIAMS: Well, the allegation is in the fact
21 that the shares are being transferred to these entities in a
22 coordinated fashion at the direction of the issuer.

23 THE COURT: At what point was Vermont no longer
24 entitled to rely on the previously filed registration statement
25 before executing sales?

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1 MR. WILLIAMS: Previously executed -- well, your
2 Honor, that's the thing. Is that when we're talking about
3 control here, and when your Honor is asking where our
4 allegation is, the issue of control is relevant to Verdmont's
5 status as an underwriter. Which is relevant to their claim for
6 an exemption, but it is not relevant to our prima facie
7 violation case. So we haven't undertaken to plead facts that
8 would necessarily undermine every exemption that Verdmont might
9 or might not rely on. We don't believe we have to do that.

10 What we have to do, what Verdmont has to do, is to
11 prove it's entitled to an exemption. And we think that the
12 Second Circuit said in *SEC v. Culpepper* that they have to prove
13 that their clients were not underwriters. They have to prove
14 that their clients were not taking from the issuer. We think
15 they have to prove that in order to prove their entitlement to
16 a exemption.

17 The prima facie case deals with the sales of
18 securities made by Verdmont in accounts in the name of Verdmont
19 in the United States that were not described on any
20 registration statement anywhere. If you sell a security that
21 is not described in a registration statement, then you have to
22 prove entitlement to an exemption.

23 THE COURT: But there was a registration statement
24 here, right?

25 MR. WILLIAMS: There was a registration statement that

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1 covered prior sales. Not the sales that are at issue here.

2 So, if Vermont --

3 THE COURT: Who can rely on that registration
4 statement when they were filed?

5 MR. WILLIAMS: So, Vermont's point is what we did is
6 we looked to see that these statements were subject to a prior
7 registration statement, and we assumed that any subsequent
8 trading was ordinary market trading, and there is an exemption
9 for ordinary market trading. The 4(a)(1) exemption. But
10 Congress has said that brokers and dealers are not entitled to
11 that exemption. In order for a broker or a dealer to be exempt
12 from the registration requirements, they have to satisfy the
13 4(a)(3) exemption or the 4(a)(4) exemption, both of which
14 require them to conduct some sort of inquiry or analysis into
15 whether or not they're acting as an underwriter, because they
16 are the gatekeeper.

17 But for Vermont making its accounts in the United
18 States available to these foreign IBCs, these transactions
19 wouldn't have happened. They are the gatekeepers to the U.S.
20 securities markets. For that reason they have some obligation
21 to satisfy themselves that the transactions that they're
22 undertaking are not pursuant to an issuer offering.

23 THE COURT: Assume that these registration statements,
24 these S-1s were not shams.

25 MR. WILLIAMS: Yes.

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1 THE COURT: Could Verdmont rely on them?

2 MR. WILLIAMS: Could Verdmont rely on them for what
3 purpose? To sell the securities?

4 THE COURT: For executing sales at the direction of
5 their clients.

6 MR. WILLIAMS: No. So if the clients sell securities,
7 those securities are not pursuant to a registration statement,
8 so they would have to be exempt. So Verdmont would either have
9 to show entitlement to the broker's exemption or the dealer
10 exemption. And to the extent that the sales took place within
11 40 days of an issue or offering, they would not be entitled to
12 that exemption.

13 THE COURT: But the sales did not occur within 40
14 days, did they?

15 MR. WILLIAMS: Yes. Well, they occurred within 40
16 days of what we believe the date of the public offering was.
17 They were beyond 40 days of the registration statement, that's
18 true. And I see your point, your Honor.

19 I think the answer to your question is if they sold
20 these securities pursuant to the 4(a)(3) exemption, they would
21 be entitled to that exemption if -- hold on one minute. Judge,
22 just so I'm clear on your hypothetical. Your hypothetical is
23 if the registration statements were legitimate, could Verdmont
24 sell pursuant to its customer's directions?

25 THE COURT: Correct.

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1 MR. WILLIAMS: Okay. So, I think the answer is -- I
2 think the answer is yes. But, they would have to satisfy
3 themselves, even if the registration statements were
4 legitimate, they would have to satisfy themselves that this
5 sale was not a subsequent part of the offering. The
6 registration statements themselves describe --

7 THE COURT: How would they do that? How would
8 Vermont do that?

9 MR. WILLIAMS: Sure. There is evidence in the record
10 that there were communications between Vermont and the
11 transfer agent, for instance. Vermont would e-mail the
12 transfer agent a one-sentence e-mail that said we just want to
13 make sure that this security tacks back to the registration
14 statement and that's it. Vermont could have also asked --

15 THE COURT: Didn't they do that?

16 MR. WILLIAMS: They did that, yes.

17 THE COURT: So, what more should they have done?

18 MR. WILLIAMS: They should have asked the transfer
19 agent who direct these transfers or shares. The answer would
20 have been Celtic Consultants. Who is Celtic Consultants? And
21 they would have gotten an answer to that. How were Celtic
22 Consultants able to effect these transfers in the absence of a
23 signature medallion guarantee?

24 THE COURT: These are questions that the SEC has
25 asked, and the SEC hasn't gotten an answer, has it, from Celtic

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1 Consultants?

2 MR. WILLIAMS: We've gotten an answer from the
3 transfer agent, your Honor. And the transfer agent has told us
4 that the shares were transferred at the direction -- well,
5 based on a board resolution issued by the company. And as I
6 indicated, the presence of a board resolution authorizing the
7 transfer of the shares in a coordinated fashion is substantial
8 evidence that the company is directing or is certainly playing
9 a role in controlling the transfer of these shares. That's
10 information that the transfer agent shared with us. That's
11 information that Verdmont could have obtained from the transfer
12 agent without any particular effort. It would have alerted
13 Verdmont that this is a part of an issuer distribution.

14 There are a number of different red flags that we lay
15 out in our papers, your Honor, that Verdmont could have and
16 should have made itself aware of.

17 What Verdmont did was it asked the question of the
18 transfer agent at the time it received the shares, and then
19 some weeks later, when the actual offering to the public took
20 place, Verdmont did nothing over the next few transactions.
21 And the case law makes clear that Verdmont is not a mere order
22 taker as a broker. Verdmont has obligations to make sure it is
23 not participating as part of an unregistered offering.
24 Particularly here, where the registration statements deal with
25 entities that had no business, had no revenues, and the shares

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1 are being offered to the public at a later point at which
2 promotional activities are indicating that an Internet -- what
3 had been a Internet job placement company is now mining for
4 gold and press releases with extravagant revenue projections.

5 THE COURT: Let's say for a moment that there was no
6 change in the business of the entity, but there was an
7 aggressive stock promotional campaign. Would Verdmont need to
8 file a new registration statement?

9 MR. WILLIAMS: Verdmont should have been aware of a
10 promotional campaign at the time it began executing these
11 trades in securities that had not previously been publicly
12 traded, in a situation in which they have a client selling
13 large blocks of shares of these securities, millions of shares
14 of these securities. There are a substantial number of red
15 flags along those lines.

16 We have Lornex -- and Mr. Zito made a point earlier
17 today that none of the clients had more than 5 percent of --
18 controlled 5 percent of the flow. But with respect to one of
19 the securities, you have Lornex with 4.999 percent of the float
20 and Nautilus with 4.999 percent of the float, and you look at
21 the signature cards for Lornex and Nautilus and it is the same
22 person on both accounts.

23 There are a substantial number of red flags that were
24 within either the possession of Verdmont or within Verdmont's
25 ability to obtain them that would have alerted them that they

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1 were participating in an issuer offering that was not
2 registered.

3 THE COURT: If this was a new offering or a new
4 distribution, doesn't the SEC have to allege facts that support
5 the idea that it was emanating from the issuer or an
6 underwriter?

7 MR. WILLIAMS: Your Honor, again, I think what we need
8 to allege to establish a prima facie violation of Section 5 is
9 these sales were not covered by a registration statement and
10 they were in interstate commerce.

11 With respect to whether or not this was a new issuing
12 or new distribution, I think that it is inherent in the fact
13 that the offering is not described in the prior registration
14 statement, that it is a different offering.

15 I think every time an issuer goes to the market to
16 sell its securities, either directly or indirectly through
17 intermediaries, through underwriters, it must be pursuant to a
18 registration statement. That's the whole point of the
19 registration statement, your Honor, is that the individuals who
20 are inside the company with knowledge of the company's goings
21 on need to disclose what's going on inside the company to
22 members of the public who are buying those securities.

23 THE COURT: What in the SEC's view sets Vermont apart
24 from the brokers and financial institutions involved in these
25 transactions who operated out of the United States, like

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1 Scottsdale Capital?

2 MR. WILLIAMS: Well, Vermont --

3 THE COURT: And the Bank of New York Mellon.

4 MR. WILLIAMS: Well, Vermont, number one, your Honor,
5 Vermont is receiving certificated shares which are different
6 than shares that are processed electronically through a
7 computer. They're receiving from a client, they're handing
8 them a stack of a million shares and this certificate. That in
9 and of itself is a substantial indication that these are shares
10 that are emanating directly from the issuer. That's how you
11 get the certificated shares at least in the first instance.
12 And the shares are of substantial volumes. There are millions
13 of shares. And the sales transactions that take place take
14 place in accounts in the name Vermont.

15 And if you ask the U.S. broker-dealers whose account
16 this is, they say it's Vermont's account. And yeah, we knew
17 the customer, our customer was Vermont. Vermont is the one
18 undertaking these transactions.

19 THE COURT: It almost sounds to me like with your
20 reference to the Ninth Circuit case that you are suggesting
21 that brokers should treat registered securities as unregistered
22 when performing due diligence. What is the point of having the
23 registration statement if you're required to make all these
24 inquiries?

25 MR. WILLIAMS: Well, typically, when you talk about a

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1 registered security, your Honor, I think you're referring to
2 the restrictive legend that appears on the security that
3 indicates whether or not the stock is re-traded. I don't think
4 that running a security through a registration -- through a
5 registered offering and having the restricted legend removed
6 eliminates you from the requirements of Section 5. I think
7 that's frankly what was going on here. Is that there were
8 these offerings, whereby -- and the offerings were unusual,
9 your Honor, in that most times, when issuers go to the market
10 to sell their securities pursuant to the registration
11 statement, it is done for the purpose of raising money for the
12 company. That's the main reason that companies go to the
13 market to sell their securities.

14 These are not done for that purpose. These were done,
15 well, we think it was done for the purpose of eliminating the
16 restrictive legend from the securities and for no other
17 purpose. But if there was any purpose for these transactions
18 other than that, it is not apparent to us. These were
19 securities that were sent to the transfer agent, the
20 restrictive legend was removed, and they were sent back to
21 where they came from. There they stayed for, as far as anyone
22 knew, until these transactions were directed at the behest of
23 Celtic Consultants, facilitated by board resolutions of the
24 companies themselves, into these IBC accounts who all began
25 trading on a coordinated basis on what appears to be the same

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1 day shortly after promotional activities began.

2 So I think that the ordinary case of someone buying an
3 issuer security pursuant to an offering and having a broker
4 deposit them in the account and then trading securities, is a
5 bit different than a case of an offering undertaken by a
6 company that does no business, undertakes the offering not to
7 raise any money or for any other apparent legitimate purpose,
8 and then the security is sent back to the company, at which
9 point they remain until they're distributed to these offshore
10 IBCs where trading can commence shortly after promotional
11 activities begin.

12 THE COURT: In your argument today, you used the
13 adjective simulated registration statement. In your motion
14 papers, you used the adjective sham registration statement.
15 How is a broker-dealer supposed to know whether a registration
16 statement is really just a fiction, a sham, or as you've said,
17 simulated, by which I assume you mean fiction, if it has been
18 filed with the SEC and deemed effective.

19 MR. WILLIAMS: And the broker's exemption, your Honor,
20 would on its face exempt transactions that a broker undertakes
21 with respect to securities that have previously been subject to
22 registration statements on its face. It says broker's
23 transactions executed upon customer orders on any exchange or
24 over-the-counter market but not the solicitation of such
25 orders.

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1 That language by its terms covers what your Honor is
2 asking about. But the case law has evolved in such a way that
3 brokers are under an obligation to conduct an inquiry for the
4 reason that they are the gatekeeper. They have unique access
5 to our markets. They're responsible to ask hard questions, not
6 just to their customer, but undertake an independent analysis
7 to ensure that they're not participating in an issue or
8 offering. And we've laid out any number of different red flags
9 that would have been presented to them that they did not
10 uncover that would disallow them that exemption, even though by
11 the language of the exemption they qualify for it.

12 THE COURT: Anything further?

13 MR. WILLIAMS: No, your Honor.

14 THE COURT: Thank you. Mr. Zito, anything further?

15 MR. ZITO: Yes. I think I'll have quite a bit, your
16 Honor.

17 The SEC, your Honor, is conflating basically the two
18 exemptions. There are two exemptions. There is a dealer
19 exemption and there is a broker exemption. The dealer
20 exemption does not require due diligence. And the dealer
21 exemption is actually lost in the event that the dealer is
22 participating in an underwriting. A broker exemption does
23 require due diligence, and it supersedes any underwriting.
24 Even assuming that a broker is acting on behalf of an
25 underwriter unknowingly, that is a defense. But these are two

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1 separate exemptions.

2 I want to deal with the dealer exemption first. Under
3 Section 4(a)(3), the dealer exemption is very clear that a
4 dealer is exempt for anything other than trades that occur
5 within the 40 days of when the effective date -- or the
6 security is offered bona fide to the public. There is case law
7 which we've cited, it is the *Finkel v. Stratton* case which is a
8 F.Supp. case here in the Southern District of New York, 2000.
9 "A security is bona fide offered to the public at the effective
10 date of the registration statement." That is the case.

11 The SEC is now arguing, well, that date should not be
12 used because this was all a sham. And it is all a sham. Well,
13 what point, I think your Honor asked this question. At what
14 point was it offered to the public. Your Honor asked that
15 question. If that's not the date, and if I may, your Honor, go
16 over to this.

17 If these red dates are not the dates when the
18 securities were offered to the public, 11/11, 7/12, 3/4/11, and
19 concededly, all these transactions occur well after that 40-day
20 period. And the case law I just cited, your Honor, is that is
21 the date that you look at. That's the date you look at.

22 But now he's saying this was a sham so you can't look
23 at that date. So the next question is, assuming they're right.
24 Assuming only arguendo, when was it genuinely offered to the
25 public? It was at least no later than this date. 8/8/12. And

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1 at least somewhere in here, 5/31/13, when Verdmont's customers
2 acquired it.

3 There is no allegation here, your Honor, that the
4 customers of Verdmont were in any way affiliates or related or
5 controlled by the issuer. That's not the allegation here. So,
6 they are the public. So if they got the stock at these dates,
7 your Honor, we then have to look to when did they sell it. Was
8 it 40 days after that. And we provided the Court with a graph
9 of that. It is on page 14 of our opening memo of law and
10 moving memo of law. It is the fifth column of that graph. And
11 it shows the date when the securities were first purchased by
12 Verdmont's customers. And then it shows when the sales
13 occurred.

14 If your Honor compares these two columns you'll see
15 that the shortest period of time is two months, three months.
16 And that's in the Norstra offering. In some instances, the
17 trades don't happen for a year. So it is well past 40 days.
18 Even giving Mr. Williams the credit of that argument, he's
19 still wrong, because it is still more than 40 days when the
20 securities ultimately rest with the public.

21 But that's just part of the analysis, your Honor,
22 because one thing that the SEC still has not addressed is how
23 was there control over the sellers of these securities. The
24 securities that sold to Verdmont's customers. How was there
25 control. And how do we define control.

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1 And the Second Circuit defines control as the
2 possession, direct or indirect, of the power to indirect or
3 cause the direction of the management and policies of a person,
4 whether the ownership of voting securities by contract or
5 otherwise.

6 THE COURT: What about the board of directors
7 resolutions?

8 MR. ZITO: That's not -- your Honor, that does not
9 withstand any scrutiny. What that is, is an indemnification to
10 the transfer agent. It says "Be it resolved, transfer agent
11 for this corporation be and hereby is directed to process the
12 transfer request regarding certificate and this board of
13 directors does hereby extend this corporation's irrevocable
14 agreement to indemnify said transfer agent for all loss."

15 All that is saying, all that is doing is the transfer
16 agent says, well, I don't want to transfer this stock unless it
17 is a bona fide certificate. So they go to the corporation.
18 They say, well, are these bona fide certificates. You know, if
19 we're going to transfer this, we don't want to transfer
20 fraudulent certificates. This is a routine document. Every
21 stock transaction has an indemnification from the company.
22 That doesn't demonstrate control.

23 And that's the other problem with the SEC's arguments,
24 your Honor, is they say control. These transactions were
25 controlled. The transactions were controlled. That's not

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1 their burden. Their burden isn't to show that the transactions
2 were controlled. Their burden is to demonstrate that these
3 entities were controlled by the issuer. They're talking about,
4 well, control, there is some sort of control and there is
5 direction on transferring these stocks. But they haven't come
6 up with a scintilla of any kind of evidence or even an
7 allegation in the complaint as to how these entities, the
8 sellers of the stock were controlled, therefore making our
9 customers underwriters. They must show that they were
10 controlled. They don't even mention these entities in the
11 complaint, your Honor. If they don't even mention these
12 entities in the complaint, how can they explain how they were
13 controlled by the issuer? That's what control means.

14 With respect to the broker exemption, your Honor, the
15 SEC still has not explained what possibly Verdmont could have
16 done to find out again how these entities were controlled. The
17 fact that there is a board resolution, that doesn't mean that
18 they're controlling anything. And when I say control, they
19 must demonstrate that the sellers of the securities were
20 controlled by the issuer. They paint with a broad brush
21 control.

22 We don't know who Celtic Consultants is. The SEC
23 doesn't even know who Celtic Consultants is. We don't know who
24 the shareholders of Celtic Consultants are. We don't know who
25 the officers and directors of Celtic Consultants are. We don't

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1 know if there is joint ownership between the issuer and Celtic
2 Consultants. They are a consultant.

3 They are looking at ghosts in this case. They see
4 that documents are being transferred. Well, the stock
5 certificates were sent back to the company. There is nothing
6 untoward about that. The company asked to have new
7 certificates issued by transfer agent. The company gets it.
8 The company then reissues the stock to the stockholders as an
9 accommodation. That's a neutral fact. There is nothing
10 untoward about that. They haven't demonstrated any control, at
11 all, over those entities that sold stock to Vermont's
12 customers.

13 Your Honor, we need to prove only two facts in this
14 case. And these are two facts that are undisputed and
15 undisputable. And that fact is, one, when was the effective
16 date of the registration statements. That's on EDGAR. It is
17 in our brief. It is not contested, it is not contestable. The
18 other fact is when Vermont's customers, the alternative
19 effective date or when it was offered bona fide to the public,
20 is when Vermont's customers received the stock. So even
21 giving Mr. Williams the benefit of his argument, he's still
22 wrong. Because we still have 40 days after that when the sale
23 of the stocks occur. And that is undisputed and is
24 undisputable.

25 Your Honor, I want to talk a little bit about the

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1 searching nature of this motion. This is not just a motion to
2 dismiss, and this is not merely a motion that says, well, have
3 they stated a cause of action, regardless of whether there is a
4 basis for it. But this is a searching motion. We have
5 attached documents, we have given the Court evidence of our
6 position, we've submitted volumes of affidavits of merits.
7 We've submitted volumes of documentary evidence showing how the
8 trades occurred.

9 The only thing that the SEC has submitted is a
10 declaration from an SEC lawyer, and some documents that they
11 obtained from overseas regulators that we don't even know what
12 they are. How are they going to prove their case? If we go
13 forward, your Honor, are they going to take testimony of these
14 people in Ireland, these people in Bosnia, these people in
15 Belize? Is this how we're going to conduct this case? Or
16 shouldn't that have been investigated beforehand and so we know
17 what we're dealing with.

18 I have nothing further, your Honor.

19 THE COURT: Mr. Williams.

20 MR. WILLIAMS: Thank you, your Honor. To Mr. Zito's
21 point on, first of all, to Mr. Zito's point on the question of
22 control. I think a threshold issue is who has the burden in
23 that respect. The issue of control is relevant to Vermont's
24 underwriter status, relevant to Vermont's client's underwriter
25 status, is relevant to Vermont's affirmative defense. We

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1 don't have the burden of negating every affirmative defense in
2 our complaint. And furthermore, it is Vermont's burden to
3 prove the existence of an exemption. This is why they're
4 required to undertake this searching inquiry, your Honor. This
5 is why they're under an obligation to find out exactly where
6 these shares come from, to ensure they don't come from an
7 issuer offering, your Honor.

8 Mr. Zito read the language of the board resolution
9 that dealt with the control issue, and the resolution -- he
10 read it correctly -- it dealt with directing the transfer agent
11 to transfer these shares from one individual to the other. And
12 Mr. Zito says, well, the SEC doesn't have any indication that
13 the issuer controlled Tamarind's investments or Pegasus Global
14 or Isla Invesco, and that's true.

15 What we have is evidence that the company controlled
16 the shares that were in the names of those entities. And if
17 they controlled those shares, then they're exercising control,
18 irrespective of who those entities are, irrespective if they
19 agreed to transfer the shares. What those board resolutions
20 do, if Tamarind Investments wanted to sell its securities to
21 Bartlett Trading, it executed an agreement, the transfer agent
22 would not have transferred those shares. If Tamarind
23 Investments doesn't exist, and the transfer certificate was
24 forged, with the board resolution, those shares are
25 transferred. The board resolution is the operative vehicle by

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1 which the shares transferred, irrespective of what the share
2 transfer agreements said.

3 The companies made these transfers happen. And the
4 companies making these transfers happen suggests that the
5 company is exercising control over the shares of those
6 entities, whoever the entities are.

7 And if the company is exercising control over millions
8 of shares of its own securities in these transactions, then
9 this is an issuer offering.

10 And Mr. Zito points to the dates in his papers by
11 which Verdmont's client's obtained the shares. These were
12 private offerings. This is not the date in which the
13 securities were bona fide offered to the public. These
14 securities were bona fide offered to the public on the day
15 after the first press release was issued and the public trading
16 commenced. That was the day it was offered to the public. Not
17 these sort of private transactions that may or may not have
18 taken place, but were effected, unquestionably effected by
19 virtue of board resolutions directing the transfer of shares.
20 This was an issuer offering, and the date these securities were
21 bona fide offered to the public are the date that these issuer
22 affiliates started selling.

23 THE COURT: What has the SEC shown to rebut Verdmont's
24 evidence of the dealer's exemption?

25 MR. WILLIAMS: We've shown, your Honor, the dealer's

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1 exemption does not apply if Verdmont is selling for an
2 underwriter, and Mr. Zito acknowledges as much. We've shown
3 that Lornex and the various other entities were in common
4 control, at least the securities of Lornex and these various
5 other entities were under the common control of the issuer by
6 virtue of the issuer directing these shares to be transferred.

7 Does that evidence support the inference of control?
8 We submit it does, your Honor. I don't know what more evidence
9 of issuer exercising control over transfer of shares you can
10 have other than a board resolution saying transfer these
11 shares.

12 The cases we cited support the proposition if you have
13 the power to effect the transfer of the shares, you control
14 those shares, whoever's name is on them. That's not just the
15 *Platforms Wireless* case. That's also *SEC v. Kern*, that's also
16 the *SEC v. CR Brokerage* that we cited from the Sixth Circuit.
17 Same situation where you have individuals working in concert
18 with the control person, and they are allowing this person to
19 direct the transfers of their shares. So we presented
20 substantial evidence that the issuer is exercising control over
21 all of the shares of these companies.

22 THE COURT: Are any of the shares still trading, by
23 the way?

24 MR. WILLIAMS: Are any of the shares --

25 THE COURT: Right.

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1 MR. WILLIAMS: Our understanding is that Vermont's
2 clients sold all of their shares during the periods relevant to
3 the complaint. There is no trading suspension on the shares.
4 So the shares are still active. But there is no -- limited or
5 no activity in the securities.

6 THE COURT: Is that what the SEC said in the other
7 case that it filed here in this district that's before Judge
8 Sweet related to the Norstra?

9 MR. WILLIAMS: Is --

10 THE COURT: Shares.

11 MR. WILLIAMS: Is what the SEC --

12 THE COURT: That they're not traded. That they're not
13 trading.

14 MR. WILLIAMS: I believe that there was a trading
15 suspension in Norstra briefly, but those are temporary.

16 THE COURT: In Norstra you're going after the issuer,
17 aren't you?

18 MR. WILLIAMS: Yes. Your Honor, I think that even in
19 this case, our investigation in this case is ongoing. We're
20 trying to make a concerted effort to go after the gatekeepers
21 in this case, the avenue by which the shares were sold. In
22 that context, Vermont is the entity that provided the forum
23 for the U.S. security markets for all of these sales.

24 THE COURT: Why in the SEC's view wasn't the Norstra
25 case related to this case since you are going after the issuer?

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1 MR. WILLIAMS: The conduct, obviously the conduct does
2 overlap a little bit. But in that case, it is a fraud case
3 against the issuer for misrepresentations and fraud. This is a
4 case involving unregistered sales of securities. Certainly the
5 unregistered sales benefited from and profited from that
6 illegal promotion. But, the individuals at issue in that case
7 are different than the individuals in this case.

8 THE COURT: You don't think there would be any
9 judicial economy or you just want to get away from me.

10 MR. WILLIAMS: That's not the issue, your Honor.
11 Would there be judicial economy in --

12 THE COURT: It is hard to see what issue there is,
13 other than a little judge shopping.

14 MR. WILLIAMS: That's not the issue, your Honor.

15 THE COURT: Well then, what is the issue? Since by
16 your own admission there is overlap you've said, and they're
17 related.

18 MR. WILLIAMS: To my knowledge, we brought to the
19 attention of Judge Sweet the related nature of the cases.

20 THE COURT: You didn't file the case in that fashion.
21 All right. Your civil cover sheet puts an obligation on you as
22 a litigant in this court to mark a case as possibly related to
23 another case pending in this court. Doesn't it?

24 MR. WILLIAMS: Yes, your Honor.

25 THE COURT: So, why didn't you mark it as possibly

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1 related to another case pending in this court?

2 MR. WILLIAMS: It should have been so marked, your
3 Honor. To the extent it wasn't, that issue was brought to the
4 attention of Judge Sweet.

5 THE COURT: Anything else?

6 MR. WILLIAMS: Nothing else, your Honor.

7 THE COURT: The government prevails when they play
8 everything above board. I'm paraphrasing the Supreme Court.
9 I'm sure you know what case I'm talking about.

10 The letter that your commission wrote to Judge Sweet
11 endeavored to explain why the cases were different, and why you
12 didn't file it in the first instance. And so, it's plainly
13 obvious to anyone exactly what the SEC was up to here. And I'm
14 just putting you on notice that if it happens again, I'm going
15 to take it up with other authorities and I'll take action on
16 it, because it is an abuse.

17 Decision reserved. Have a good afternoon.

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